MONTANA UNIVERSITY SYSTEM

WORKERS' COMPENSATION PROGRAM

Prepared Under Contract With:
MONTANA LEGISLATIVE BRANCH, AUDIT DIVISION
PO Box 201705, Helena, MT 59620-1705

MONTANA UNIVERSITY SYSTEM - WORKERS' COMPENSATION PROGRAM

AUDITED FINANCIAL STATEMENTS
With Supplemental Information

June 30, 2010 and 2009

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors:
James Gillett
Angie Grove

November 2010

The Legislative Audit Committee
of the Montana State Legislature:

Enclosed is the report on the audit of the Montana University System Workers' Compensation Program for the fiscal year ended June 30, 2010.

The audit was conducted by Junkermier, Clark, Campanella, Stevens, P.C., under a contract between the firm and our office. The comments and recommendations contained in this report represent the views of the firm and not necessarily the Legislative Auditor.

Respectfully submitted,

Tori Hunthausen, CPA
Legislative Auditor

10C-04

Room 160 · State Capitol Building · P.O. Box 201705 · Helena, MT · 59620-1705
Phone (406) 444-3122 · FAX (406) 444-9784 · E-Mail lad@mt.gov
http://leg.mt.gov/audit

MONTANA UNIVERSITY SYSTEM -
WORKERS' COMPENSATION PROGRAM
CONTENTS

Junkermier • Clark
Campanella • Stevens • P.C.
Certified Public Accountants and Business Advisors

P.O. Box 1164
Helena, Montana 59624
ph. (406) 442-6901
fx. (406) 442-9690
www.jccscpa.com

INDEPENDENT AUDITORS' REPORT

To the Committee
Montana University System -
Workers' Compensation Program
Helena, Montana

We have audited the accompanying financial statements of the Montana University System - Workers' Compensation Program (an enterprise fund of the State of Montana) as of and for the years ended June 30, 2010 and 2009, as listed in the table of contents. These financial statements are the responsibility of the Montana University System - Workers' Compensation Program's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements present only the Montana University System - (Workers' Compensation Program) and do not purport to, and do not, present fairly the financial position of the State of Montana as of June 30, 2010 and 2009, and the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana University System - Workers' Compensation Program (an enterprise fund of the State of Montana) as of June 30, 2010 and 2009 and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 27, 2010, on our consideration of Montana University System - Workers' Compensation Program's internal control over financial reporting and our tests of its compliance with laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. The report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

The accompanying Management Discussion and Analysis is not a required part of the basic financial statmenets but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the mehtods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The claims development information on page 14 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Junkermier, Clark, Campanella, Stevens, P.C.

Helena, Montana
October 27, 2010

Management of the MUS Workers' Compensation Program provides this *Management's Discussion and Analysis* of the Program's financial statements. This narrative overview and analysis of the financial activities of the Program is for the fiscal year ended June 30, 2010. It should be read in conjunction with the Program's financial statements, which begin on page 9.

Message From the Director

The MUS Self-Funded Workers' Compensation Program continued in fiscal year 2010 to meet the challenge of its Mission Statement to "efficiently, expeditiously and cost effectively handle workers' compensation claims in the best interests of the program and the employees." By acknowledging that the best interests of *both* the Program *and* the employees it serves can be accomplished, the Program presents a unique mindset among many in the workers' compensation arena. Though perhaps unique in industry, it is a philosophy consistent with MUS' recognition that employees are our most important assets and that we have a duty to use resources wisely. I am committed to working every day to achieving the best interests of the Program and the employees, the campuses and the public we serve.

We concluded fiscal year 2010, the Program's 7th year in operation, with fewer claims than in 2009 and premium rates that have remained flat for the past 3 years. We pursued a rigorous Request for Proposal process that has strengthened our Program by thoroughly examining our current practices and expectations and better defining relationships with our service providers. The scrutiny and resulting TPA contract will facilitate an even higher level of efficient, expeditious and cost effective claims management in the best interest of the program and injured employees.

The Program can look forward to FY11 as the 4th year of stable premium rates, a healthy financial position, and a Committee and Director committed to continued improvement. As Director, I believe that the Program continues to provide MUS and its employees the best option for meeting its workers' compensation obligation, and will continue to do so over the long term. It remains an honor for me to serve as Director of the MUS Self-Funded Workers' Compensation Program.

Mission

The self-funded workers' compensation program will aggressively implement "best practices" in loss control and efficiently, expeditiously, and cost effectively handle workers' compensation claims in the best interests of the program and the employee.

Values and Vision

The MUS Self-Funded Workers' Compensation Program focuses on enhancing the safety culture throughout MUS by focusing on the value of employee well-being, the prevention of injuries and illnesses, and providing the best, fair outcome in the event of a work-related injury or illness, and returning employees to productive work as soon as it is safe to do so. The Program is committed to accomplishing its mission and to support the mission of MUS and each unit of the system by providing:

- Resources to promote a safe and healthy working environment throughout the MUS.
- Thoughtful management of injured employees to promote healing and return to work.
- Fair and timely payment of medical bills and time loss compensation throughout the claim life.
- Responsible management of MUS funds.
- Strategic planning through consultation with actuary, audit, insurance, regulatory, and other experts that help meet the best interests of MUS.
- Careful and diligent selection of partners to help accomplish our vision.

We recognize that it is vital that employees at all levels within the universities understand that injuries and losses don't just *happen*, they are *caused* and they can be *prevented*. Each Committee member is expected to actively participate in Committee meetings and to keep top administrators informed about Committee activities, workers compensation-related losses, how injuries hinder effectiveness and how they affect the bottom line. We are committed to using the Program's successes and to learn from our experiences to build sustainable success for the future.

Financial Highlights

Fiscal year 2010 premium revenue of nearly $5,000,000 is slightly lower than 2009 premium revenue and was slightly more than $5,000,000. The reduction in premium can be attributed to reduced payroll in the higher rate class (9101); total payroll in FY2010 was higher than FY2009 total payroll. The 2010 payroll and premium amounts reported are consistent with the actuary and Committee estimates used to establish 2010 rates, and the Program collected premiums adequate to cover estimated losses and contribute to its reserve.

The total assets of the Program exceeded its liabilities at the end of fiscal year 2010 by approximately $7,000,000 (reported as net assets) compared with $6,000,000 reported at the end of fiscal year 2009. Workers' Compensation wage loss and medical benefits may be payable for decades following an injury. The long term nature of workers compensation benefits demand that appropriate assets be committed to claim reserves to ensure the long-term ability of the Program to pay claims.

Rates have stabilized as the Program has matured. With rates for FY11 at only a fraction of a percent above FY08 rates.

Rate history

Rate Class	FISCAL YEAR							
	2004	2005	2006	2007	20008	2009	2010	2011
8868	0.35691	0.48655	0.527647	0.56695	0.599795	0.599795	0.599812	0.599956
Annual change		26.64%	7.79%	6.93%	5.48%	0%	0%	.02%
9101	3.04566	4.1519	4.83801	4.83801	4.858009	4.858009	4.858922	4.860089
Annual change		26.64%	14.18%	0%	0.41%	0%	.02%	.02%

The Montana Department of Labor establishes benchmarks as indicators of financial strength and ability of self-insurers to meet their workers' compensation obligations. The following are key DOL Benchmarks and MUS FY10 preliminary results:

- Equity Ratio – Montana DOL requires a minimum 25% equity ratio (net worth of total assets) of all self insurers and is the threshold measurement emphasized by DOL as an indicator of appropriate use of debt management. The MUS equity ratio of 43% at the end of fiscal year 2010 and 41% at the end of fiscal year 2009 indicate the Program has achieved and is sustaining good debt management and a healthy financial position.

- Premium: Surplus Ratio – This ratio is designed to measure the ability of the insurer to absorb above-average losses and the insurer's financial strength. The ratio is computed by dividing net premiums written by surplus. An insurance company's surplus is the amount by which assets exceed liabilities (a/k/a net worth, equity, or reserve). Montana DOL benchmark for premium to surplus ratio is a maximum of 3:1 with the lower the ratio, the greater the company's financial strength. The MUS premium to surplus ratio at the end of fiscal year 2010 is approximately 0.7:1.

- Equity: SIR Ratio – The equity to Self Insured Retention (SIR) is a measure of the resources a self-insurer has available to pay for large claim costs prior to eligibility for reimbursement by an excess insurance policy. MUS has a $500,000 SIR except for aircraft related claims which require a $1,000,000 SIR. Montana DOL benchmark is not absolute but a 10:1 has been recommended. MUS work comp program's ratio at the end of FY2010 is 14:1 for non-aircraft related claims and 7:1 for aircraft related claims.

Overview of the Financial Statements

The *financial statements* provide a broad view of the Program's operations. The statements provide both short-term and long-term information about the Program's financial position, which assists in assessing the Program's economic condition at the end of the fiscal year. These are prepared using the accrual basis of accounting; all revenues and expenses connected with the fiscal year, even if cash involved has not been received or paid are taken into account. The financial statements include: *Statement of Net Assets; Statement of Revenues, Expenses and Changes in Net Assets; and, Statements of Cash Flows*. The Program's financial statements also include the *Notes to the Financial Statement* that provides additional detail for understanding the financial statements. For purposes of this preliminary yearend report only the key FY10 financial statement measures are included with details to be provided after the audit is conducted. FY2009 audited financial statements are included in this report.

The *Statement of Net Assets* presents all of the Program's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases or decreases in the Program's net assets may serve as a useful indicator of whether the financial position of the Program is improving or deteriorating.

The *Statement of Revenues, Expenses and Changes in Net Assets* presents information showing how the Program's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as earned but unused vacation leave).

Statements of Cash Flows show how changes in balance sheet accounts and income affect cash and cash equivalents, and breaks the analysis down to operating, investing, and financing activities. Essentially, the cash flow statement is concerned with the flow of cash in and cash out of the Program. The statement captures both the current operating results and the accompanying changes in the balance

sheet. As an analytical tool, the statement of cash flows is useful in determining the short-term viability of the Program, particularly its ability to pay bills.

Notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

Current Year Financial and Budget Results

	FY 2010	2010 Budget	Variance
Revenue			
Premiums	$ 4,979,335	$ 4,892,000	$ 87,335
STIP	44,023	0	44,023
Misc. interest	682	0	682
TOTAL REVENUE	5,024,040	4,892,000	132,040
Expenses			
Personnel services	82,660	82,000	660
Operating expenses	620,556	624,100	3,544
Benefits & claims	3,190,903	2,980,000	(210,903)
TOTAL EXPENSES	3,894,118	3,686,100	(208,019)
Operating Income	$ 1,129,921	$ 1,205,900	$ (75,979)

MUS has a strong financial statement with good liquidity and a solid equity reserves ratio.

The Program's overall financial position continues to strengthen as the Program matures and continues to control workers' compensation loss costs while maintaining steady premium rates. Annually, the Program undergoes an actuarial review including a certification of loss reserves, as well as an independent financial audit and MT Department of Labor (MT DOL) Self-Insurers' regulatory department analysis and determination of financial ability to meet its obligations. All outside reviewers indicate the Program is in strong financial shape and the Program concurs.

Revenue

Preliminary 2010 financial results indicate the Program collected adequate premium revenues to cover anticipated losses and to contribute to its claim reserve fund, though at a reduced amount than in 2009. Rate setting to cover claim costs and build adequate reserves has been a primary goal of the Program since its inception in July 2003. The Program utilizes an actuarial analysis to establish annual premium needs and the Committee has consistently adopted a rate with a correspondingly high confidence level to accomplish this goal. 2010 rates were established with anticipation that payroll growth would be flat and the Program reserve contribution could be less aggressive due to its current reserve strength.

The Program earns modest interest on reserves deposited with Montana Board of investments Short Term Investment Pool (STIP) and an interest bearing bank account used to pay claim costs. The average STIP yield for Fiscal Year 2010 was 0.3416. The annual percentage yield earned from the interest bearing bank account was 0.25%. Total interest from both sources was approximately $45,000;

while not a robust rate of return, these are funds that would be ceded to an outside carrier if the MUS did not self-fund its workers' compensation program.

Expenditures

Expenditures for fiscal year 2010 were approximately $3,900,000, an increase of 6% over 2009. Claim expenses account for $3,200,000 of these expenditures. The second largest Program expense is excess insurance premiums at approximately $250,000. Self insured workers' compensation programs are mandated to carry excess insurance by MT DOL. Claim administrative costs of $210,000 were paid to the TPA in 2010, which is less than the $220,000 paid in TPA costs in 2009. The reason for the cost reduction was fewer overall claims, and significantly fewer, higher cost, indemnity claims, in 2010 than in 2009.

Net Assets

Net assets may serve over time as a useful indicator of an operation's financial position. In a self-insured workers' compensation program, net assets are often referred to as reserves. For a non-profit workers' compensation insurance program, net assets are used primarily as reserves to pay claim costs over time. The MUS Program works with its actuary to set rates adequate to cover these reserve needs. The Committee has adopted a "$afety $mart" program that allows distribution of a portion reserve funds back to campuses for safety investments *if* costs over time are lower than expected, and therefore the Program has excess reserves, and other financial criteria have been met. The Committee elected not to distribute $afety $mart funds in 2010, the first year of the program. Because several of its minimum financial benchmarks were achieved as the economy was weakening, the Committee determined it in the best interest of the Program to maintain a conservative reserve.

Investments

The Program's investments of its reserves as of June 30, 2010, amounted to approximately $14,600,000.

In January 2007, the Board of Investments (the Board) purchased a $25 million par issue of Orion Finance USA. In April 2007, the Board purchased two issues of Axon Financial Funding totaling $90 million par and another $25 million par issue of Orion Finance USA. As of June 30, 2007, these Structured Investment Vehicle (SIV) securities held in the STIP portfolio carried a combined amortized cost of $139,991,131 representing 5.02% of the total portfolio.

At the time of purchase and as of June 30, 2007, these four issues received the highest investment grade rating of AAA by Standard & Poors and Aaa by Moody's. As of June 30, 2008, these issues carried a D rating by Standard & Poors. On November 20, 2007, an insolvency event was declared by Axon Finance USA. Orion Financial Funding declared an insolvency event on January 14, 2008. On the January and April 2008 maturity dates, these securities matured at their amortized cost of $140 million.

The Board has determined that it is currently in the best interest of the STIP to continue to hold these securities in the investment portfolio. These SIV securities are currently generating cash to be applied to the securities.

The Montana University System - Workers Compensation Program's share of these investments as of June 30, 2009 and 2008 is $1,034,213 and $840,306, respectively. These are shown as long-term investments on the statement of net assets as of June 30, 2009 and 2008. This determination and value was not available for FY2010 when this report was produced.

Debt Administration

The Program does not carry any debt other than its claim liabilities.

Claim Liabilities

The Program carried total liabilities of $9,500,000 in total liabilities at the close of fiscal year 2010. Claim liabilities comprised 93% of the total liabilities with current claim liabilities at approximately $1,850,000 and non-current liabilities at $6,950,000.

Workers' compensation claims may remain open decades after an incident, and are often referred to as "long-tailed". These long tailed claims have a high level of reserve uncertainty compared to other lines of insurance and are considered some of the most difficult claims to manage and reserve. MUS Program utilizes an actuary experienced in workers' compensation to calculate its claim liability and to ensure adequate reserving for the liability.

MONTANA UNIVERSITY SYSTEM - WORKERS' COMPENSATION PROGRAM STATEMENTS OF NET ASSETS

	June 30	
	2010	2009
ASSETS		
Current Assets		
Cash and cash equivalents	$ 14,865,054	$ 12,233,511
Interest receivable	4,177	7,566
Due from component units	-	382,089
Short-term securities lending collateral	562,564	815,681
Prepaid expense	225,225	243,015
Total current assets	15 657,020	13,681,862
Noncurrent Assets		
Long-term investments	880,251	1,034,213
Total noncurrent assets	880,251	1,034,213
Total assets	$ 16,537,271	$ 14,716,075
LIABILITIES		
Current Liabilities		
Vouchers payable	$ 65,230	$ 59,428
Due to other funds	-	129,399
Due to component unit	-	39
Current portion of compensated absences liability	4,332	3,196
Current securities lending liability	562,564	815,681
Current portion of estimated claims liability	1 853,714	994,785
Total current liabilities	2,485,840	2,002,528
Noncurrent Liabilities		
Compensated absences liability - net of current portion	3,901	3,998
Estimated claims liability-net of current portion	6,947,286	6,738,215
Estimated liability - OPEB	7,730	4,789
Total noncurrent liabilities	6,958,917	6,747,002
Total liabilities	$ 9,444,757	$ 8,749,530
NET ASSETS		
Unrestricted Net Assets	$ 7,092,514	$ 5,966,545

See the notes to financial statements.

MONTANA UNIVERSITY SYSTEM - WORKERS' COMPENSATION PROGRAM STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Years ended June 30	
	2010	2009
OPERATING REVENUES		
Premiums	$ 4,979,335	$ 5,003,315
OPERATING EXPENSES		
Claims administration	207,760	222,313
Actuary fees	16,329	16,500
Consulting & Professional Services	-	31,349
Insurance and reinsurance expense	267,287	240,712
Audit fees	9,500	9,500
Dues	2,800	2,800
Department of Labor assessment	65,838	46,613
Bank Service Charges	60	88
Office supplies, printing, postage	1,820	309
Salaries, payroll taxes and benefits	83,698	83,686
Telephone	504	716
Miscellaneous expense	53,668	46,450
Claims paid and claims expense	3,190,903	2,974,436
Total operating expenses	3,900,167	3,675,472
OPERATING INCOME	1,079,168	1,327,843
NONOPERATING REVENUES (EXPENSES)		
Interest and investment income	40,656	167,866
Other nonoperating income	6,145	21,871
Total nonoperating revenues (expenses)	46,801	189,737
CHANGE IN NET ASSETS	1,125,969	1,517,580
NET ASSETS BEGINNING OF YEAR	5,966,545	4,448,965
NET ASSETS END OF YEAR	$ 7,092,514	$ 5,966,545

See the notes to financial statements.

MONTANA UNIVERSITY SYSTEM -
WORKERS' COMPENSATION PROGRAM
STATEMENTS OF CASH FLOWS

	Years ended June 30	
	2010	**2009**
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from premiums:	$ 5,361,424	$ 4,996,155
Claims paid and claims expense	(2,122,903)	(1,568,128)
Cash payments for insurance and reinsurance expense	(249,497)	(233,806)
Cash payments for employees	(82,659)	(81,395)
Cash payments for administrative expenses	(425,863)	(187,894)
Cash payments for other operating expenses	(53,111)	(45,119)
Net cash provided by operating activities	2,427,391	2,879,813
CASH FLOWS FROM INVESTING ACTIVITIES		
Reclassification of STIP to investments	153,962	(193,907)
Other nonoperating income	6,145	21,871
Interest received	44,045	173,432
Net cash provided by investing activities	,204,152	1,396
Net increase in cash	2,631,543	2,881,209
CASH BEGINNING OF YEAR	12,233,511	9,352,302
CASH END OF YEAR	$ 14,865,054	$ 12,233,511

See the notes to financial statements.

MONTANA UNIVERSITY SYSTEM -
WORKERS' COMPENSATION PROGRAM
STATEMENTS OF CASH FLOWS (Continued)

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	Years ended June 30 2010	Years ended June 30 2009
Operating Income	$ 1,079,168	$ 1,327,843
Adjustments to reconcile operating income to net cash provided by operating activities:		
Decrease in other receivables	-	94
Decrease (increase) in due from component units	382,089	(7,254)
Decrease in prepaid expense	17,790	6,906
Increase in vouchers payable	5,802	42,274
(Decrease) increase in due to other funds	(129,399)	129,239
(Decrease) in due to component unit	(39)	(24)
Increase in compensated absences liability	1,039	2,291
Increase in estimated liability - OPEB	2,941	2,444
Increase in estimated claims liability	1,068,000	1,376,000
	1,348,223	1,551,970
Net cash provided by operating activities	$ 2,427,391	$ 2,879,813

See the notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Description of Program:

The Montana University System - Workers' Compensation Program (the Program) was organized to provide self-insured workers' compensation coverage for employees of the Montana University System. The Montana University System Board of Regents elected to provide workers' compensation coverage under the Compensation Plan Number One (MCA 39-71-2101) as of July 1, 2003. Prior to that date, the Montana University System obtained its workers' compensation coverage through participation in the Montana State Fund. Each member of the Program is jointly and severally liable for the full amount of any and all known or unknown claims of each member arising during the member's participation in the program.

Administration of Claim Payments:

The Program contracts directly with Intermountain Claims, Inc. for claims administration services.

Basis of Accounting:

The Program has adopted the provisions of GASB Statement 10 (as amended by GASB Statement No. 30 and GASB Interpretation No. 4), under those provisions, the Program utilizes accounting principles applicable to public entity risk pools. The Program's financial statements are presented on the accrual basis of accounting. Revenues are recognized when they are earned, and expenses are recognized when they are incurred. Operating revenues and expenses generally arise from providing insurance coverage. All other revenues and expenses are classified as nonoperating. The Program has elected to apply the provisions of applicable pronouncements issued by the Financial Accounting Standards Board and the AICPA prior to November 30, 1989, except those that conflict with or contradict GASB pronouncements. Government entities have the option of whether or not to apply FASB pronouncements issued after that date to their proprietary activities. In accordance with GASB Statement No. 20, management has elected not to apply FASB pronouncements issued after November 30, 1989.

Reporting Entity:

The Program is considered a public entity risk pool and is reported as an enterprise fund of the State of Montana. In accordance with governmental accounting and financial reporting standards there are no component units to be included with the Montana University System-Workers Compensation Program as a reporting agency.

Bad Debts:

The Program considers all premium receivables to be fully collectible. Therefore an allowance for uncollectible premiums is not necessary.

Investments:

The Program is authorized to invest in the Short Term Investment Pool (STIP) which is administered by the State of Montana Board of Investments. The STIP portfolio includes asset-backed securities, banker's acceptances, certificates of deposit, corporate and government securities, repurchase agreements and variable-rate (floating-rate) instruments. Asset-backed securities represent debt securities collateralized by a pool of non-mortgage assets such as trade and loan receivables, equipment leases, and credit cards. Variable-rate (floating-rate) securities pay a variable rate of interest until maturity. The variable-rate securities float with the 91 day treasury bill or LIBOR (London Interbank Offered Rate).

Restricted Cash and Investments:

Under the provisions of GASB Statement 31, investments have been reported at fair value.

Investments consist of municipal obligations carried at fair value, determined by quoted market prices. Increases or decreases in fair value are recognized in the current period as investment gains or losses. Short-term investments are those with a maturity date of less than one year from the financial statement date.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Estimates:

The preparation of the financial statements in conformity with generally accepted accounting principles requires the use of management's estimates. The major estimates are unpaid claim liabilities.

Unpaid Claims Liabilities:

The Program establishes claim loss reserves for unpaid claims liabilities based on actuarial estimates of the ultimate cost of claims (including future allocated claim adjustment expenses) that have been reported but not paid or settled and that have been incurred but not reported. The liability includes the unallocated claims adjustment expense. The liabilities are based on the estimated ultimate cost of settling the reported and unreported claims, and claims reserve development including the effects of inflation and other societal and economic factors. Estimated amounts of subrogation and reinsurance recoverable on unpaid claims are deducted from the liability for unpaid claims. Estimated claims liabilities are recomputed periodically based on current reviews of claims information, experience with similar claims and other factors. Adjustments to estimated claims liabilities are charged or credited to expense in the periods in which they are made.

The Program is self-insured for workers' compensation claims to a maximum of $500,000 per each occurrence. Losses in excess of $500,000 are covered by reinsurance with a commercial carrier. Employer's liability claims are covered to a maximum of $1,000,000 above the self-insured amount of $500,000. During the fiscal year ended June 30, 2010 and 2009, the Program ceded $267,287 and $240,712 in premiums to reinsurers.

Cash and Cash Equivalents:

Cash and cash equivalents consist of cash in checking accounts, specific investments held on behalf of the Program and pooled accounts with the Montana Board of Investments Short-Term Investment Program. For purposes of the statement of cash flows, the Program considers all highly liquid debt instruments purchased with initial maturities of three months or less to be cash equivalents.

Premium Revenue:

Premium rates are established by the Program's Committee based on anticipated premium needed as determined by the actuary. Premium rates are adjusted periodically based on inflation, claims experience, and other factors. Premiums are recorded as revenue in the period for which coverage is provided. Members may be subject to supplemental assessments in the event of deficiencies. The Program considers anticipated investment income in determining if a premium deficiency exists.

Due from Component Unit:

These amounts represent premium receivable from a component unit (Montana University System) of the State of Montana.

2. CASH AND INVESTMENTS

Cash and cash equivalents at June 30 consist of the following:

	2010	2009
Cash in bank	$ 1,146,927	$ 836,757
Cash in Montana Board of Investments STIP Program	13,718,127	11,396,754
Totals	$ 14,865,054	$ 12,233,511

The following table presents the cost and the fair value of investments at June 30,

	2010		2009	
	Cost	Fair Value	Cost	Fair Value
Structured investment vehicles	$ 880,251	$ 880,251	$ 1,034,213	$ 1,034,213

Effective June 30, 2005, the Program implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 "Deposits and Investment Risk Disclosures". The investment risk disclosures are described in the following paragraphs.

Legal and Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

In January 2007, the Board of Investments (the Board) purchased a $25 million par issue of Orion Finance USA. In April 2007, the Board purchased two issues of Axon Financial Funding totaling $90 million par and another $25 million par issue of Orion Finance USA. As of June 30, 2007, these Structured Investment Vehicle (SIV) securities held in the STIP portfolio carried a combined amortized cost of $139,991,131 representing 5.02% of the total portfolio. At the time of purchase and as of June 30, 2007, these four issues received the highest investment grade rating of AAA by Standard & Poors and Aaa by Moody's. As of June 30, 2008, these issues carried a D rating by Standard & Poors. On November 20, 2007, an insolvency event was declared by Axon Finance USA. Orion Financial Funding declared an insolvency event on January 14, 2008. On the January and April 2008 maturity dates, these securities matured at their amortized cost of $140 million. The Board has determined that it is currently in the best interest of the STIP to continue to hold these securities in the investment portfolio. These SIV securities are currently generating cash to be applied to the securities.

The Montana University System - Workers Compensation Program's share of these investments as of June 30, 2010 and 2009 is $880,251 and $1,034,213, respectively. These are shown as long-term investments on the statement of net assets as of June 30, 2010 and 2009.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. GASB 40 requires that a government entity disclose the amount invested in a separate issuer (except investments held in the U.S. government or investments guaranteed by the U.S. government) when that amount is at least 5% of total investments. As of June 30, 2010 and 2009 the Program had Structured Investment Vehicles that made up 100% of the total investments of $880,251 and $1,034,213, respectively.

2. CASH AND INVESTMENTS (Continued)

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of the outside party. Cash and money market funds are insured.

Information regarding the collateralization and risk of funds held by the Short Term Investment Pool (STIP) is available in the Board of Investment's comprehensive annual financial report. There is no regulatory oversight for the investment pool, and the pool does not have a credit quality rating. Participants' equity in the pool approximates the fair value of the underlying investments.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Program investment policies do not formally address interest rate risk. In accordance with GASB Statement No. 40, the Program has selected the effective duration method to disclose interest rate risk.

GASB Statement No. 40 defines duration as a measure of the debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price. Effective duration makes assumptions regarding the most likely timing and amounts of variable cash flows arising from such investments as callable bonds, prepayments, and variable-rate debt.

3. RELATED PARTIES

Certain employees of the campuses of the university system provide services to the Program at no charge. The value of such services has not been determined.

4. UNPAID CLAIMS LIABILITIES

As discussed in footnote 1, the Program establishes actuarial estimated unpaid claims liabilities. The estimated unpaid claims incurred but not reported and loss development liability have been adjusted to reflect the actuarial estimates of the ultimate cost of claims. The management of the Program has set the unpaid claims liability at the actuary's best estimate for 2010 and 2009. The following represents changes in the aggregate unpaid claims liabilities for the Program for:

	2010	2009
Total present value of estimated unpaid claim losses at beginning of year	$ 7,733,000	$ 6,357,000
Changes in the estimated unpaid claim losses:		
Provision for insured events of the current year	2,959,000	2,922,000
Increase (decrease) in provision for insured events of prior years	,256,299	, 22,128
Total incurred claims	3,215,299	2,944,128
Payments (including claims legal defense):		
Claims paid attributable to insured events of current year	572,486	640,717
Claims paid attributable to insured events of prior years	1,574,813	,927,411
Total payments	2,147,299	1,568,128
Total present value of estimated unpaid claim losses at end of year	$ 8,801,000	$ 7,733,000

The estimated liability for workers' compensation claims as of June 30, consist of the following:

	2010	2009
Estimated claims reported but unpaid	$ 1,853,714	$ 994,785
Estimated claims incurred but not reported and loss development	6,947,286	6,738,215
	$ 8,801,000	$ 7,733,000

MONTANA UNIVERSITY SYSTEM - WORKERS' COMPENSATION PROGRAM
CLAIMS DEVELOPMENT INFORMATION

	Fiscal and Policy Year Ended						
	2004	2005	2006	2007	2008	2009	2010
1. Net earned (required contribution and investment revenues	$ 2,273,944	$ 2,850,849	$ 3,510,259	$ 4,153,570	$ 4,777,099	$ 4,930,524	$ 4,752,704
2. Unallocated expenses	227,267	279,716	263,904	259,412	386,512	460,508	441,977
3. Estimated incurred claims and expenses, end of policy yeai	2,174,000	2,366,000	2,453,000	2,600,000	2,693,000	2,922,000	2,959,000
4. Net paid (cumulative) as of:							
End of policy year	551,749	382,154	390,972	367,913	469,399	640,717	572,486
One year later	1,019,751	1,001,996	910,335	932,787	1,099,932	1,764,405	
Two years later	1,123,504	1,227,600	1,254,242	1,092,644	1,286,205		
Three years later	1,147,508	1,526,088	1,351,046	1,157,520			
Four years later	1,165,362	1,554,903	1,386,285				
Five years later	1,210,361	1,660,121					
Six years later	1,251,309						
5. Reestimated ceded claims and expenses	-	-	-	-	-	-	-
6. Reestimated net incurred claims and expenses							
End of policy year	2,174,000	2,366,000	2,453,000	2,600,000	2,693,000	2,922,000	2,959,000
One year later	2,174,000	2,565,000	2,267,356	2,293,413	2,686,541	3,046,000	
Two years later	2,037,000	2,459,000	2,510,000	2,412,000	2,630,000		
Three years later	1,830,000	2,602,000	2,471,000	2,131,000			
Four years later	1,570,000	2,622,000	2,069,000				
Five years later	1,499,000	2,312,000					
Six years later	1,327,000						
7. Increase (decrease) in estimated net incurred claims and expenses from end of policy year	(847,000)	(54,000)	(384,000)	(469,000)	(63,000)	124,000	-

See the accompanying independent autitors' report on supplemental information

Junkermier • Clark
Campanella • Stevens • P.C.

P.O. Box 1164
Helena, Montana 59624
ph. (406) 442-6901
fx. (406) 442-9690
www.jccscpa.com

Certified Public Accountants and Business Advisors

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Committee
Montana University System - Workers' Compensation Program
Helena, Montana

We have audited the financial statements of Montana University System - Workers' Compensation Program, (an enterprise fund of the State of Montana) as of and for the years ended June 30, 2010 and 2009, and have issued our report thereon dated October 27, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Montana University System - Workers' Compensation Program's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Montana University System - Workers' Compensation Program's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Montana University System - Workers' Compensation Program's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Montana University System - Workers' Compensation Program's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Montana University System - Workers' Compensation Program's financial statements that is more than inconsequential will not be prevented or detected by the Montana University System - Workers' Compensation Program's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Montana University System - Workers' Compensation Program's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Montana University System - Workers' Compensation Program's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

This report is intended solely for the information and use of the audit committee, management, others within the Montana University System - Workers' Compensation Program, and is not intended to be and should not be used by anyone other than these specified parties.

Junkermier, Clark, Campanella, Stevens, P.C.

Helena, Montana
October 27, 2010

MONTANA UNIVERSITY SYSTEM
OFFICE OF THE COMMISSIONER OF HIGHER EDUCATION

2500 Broadway – PO Box 203201 – Helena, Montana 59620-3201
(406) 444-6570 – FAX (406) 444-1469

November 10, 2010

Junkermier, Clark, Campanella, Stevens, P.C.
Certified Public Accountants
P.O. Box 1164
Helena, Montana 59624

RE: Montana University System – Workers Compensation Program response

Dear Junkermier, Clark, Campanella, Stevens, P.C.

We have reviewed the draft audit report for the Montana University System – Workers Compensation Program. We are pleased that our Program meets accounting standards and that no recommendations for improvement were noted.

Sincerely,

Leah Tietz
Leah Tietz
Program Director